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HEADLINE: Tobacco profits still a picture of health

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BODY:

The anti-smoking movement in the U.S. met with unprecedented success in the decade just past.

Smoking has been declared a passive health hazard by the U.S. Environmental Protection Agency. The American Medical Association has assailed the export of U.S. cigarettes. Smoking is banned on nearly all domestic flights, in two out of five offices, in most public places. Smoking is even being banned in a growing number of jails in America.

Domestic consumption continues to decline, dropping another 4 percent in 1989, and smoking, once considered socially acceptable and sophisticated, is viewed by a majority of Americans as a stupid, filthy habit dangerous to everyone.

The dread tobacco industry is on the run, right?

Wrong. Though the fact infuriates the anti-smoking forces, the tobacco industry also prospered in the 1980s.

"Despite long-term concerns about cigarette consumption trends, excise tax increases and litigation developments, cigarette stocks since 1981 have outperformed the Standard & Poor's 500-stock index in every year but one (1985)," said Dean Witter Reynolds Inc. analyst Lawrence Adelman.

U.S. tobacco exports exploded in the mid-1980s. They leaped 25 percent last year and are up again, to $1.8 billion in the first five months of 1990. Even in Japan, a notoriously difficult market, U.S. tobacco products have 14 percent of the market, up from 3 percent just three years ago.

If this kind of performance were turned in by any other industry, it would be hailed as a sterling example of American efficiency, marketing brilliance and superior quality.

But tobacco carries with it the health-hazard baggage. Since the U.S. surgeon general's first report on the dangers of smoking in 1964, the industry has been portrayed as "merchants of death." And so an industry that serves 49 million people, employs more than 700,000, generated a positive trade balance of $3.7 billion and paid nearly $10 billion in federal, state and local excise taxes in 1988 is under attack on all fronts.

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If making and selling cigarettes weren't so profitable, companies such as Philip Morris Cos., RJR Nabisco Inc., Loews Corp., American Brands Inc., UST Inc. and Liggett Group Inc. probably would determine that the regulatory hassle, constant litigation and negative image aren't worth it.

But few manufactured products are as profitable as cigarettes. They are virtual money machines. Operating profit margins for tobacco products range from 40 to 50 percent, said Kurt Feuerman, tobacco analyst with Morgan Stanley & Co.

Tobacco is the second most capital-intensive industry in the nation behind petroleum, said Farrell Delman, president of the Tobacco Merchants Association of the U.S. Inc. Machines can make 10,000 cigarettes a minute, he added.

And they are sold 20 to a pack at increasingly high prices, currently an average $1.60 in the U.S. Consumer prices for tobacco products in the U.S. have risen 6 to 19 percent every year since 1980.

So, financially, it is clearly worth it. Calvert Crary, analyst with Labe, Simpson & Co., likens tobacco to an oil field. "As long as the oil keeps flowing, this extraordinarily dangerous product will be profitable," he said.

In fact, he added, "Tobacco companies are addicted to the profits from cigarettes to an even higher (degree) than smokers are addicted to nicotine."

Many tobacco companies have put their immense profits and excess cash from selling cigarettes, cigars, chewing tobacco and the like into non-tobacco, and more socially respectable, areas.

R.J. Reynolds Tobacco Co. bought Nabisco Brands Inc. in 1985, creating RJR Nabisco. The Liggett Group not only has diversified out of tobacco and into sports cards and candy, but it also changed its name last month to the Brooke Group Ltd.

Loews bought an insurance company in the 1970s and recently has purchased oil rigs. (Loews is the chief investment vehicle for the Tisch family, which also has a controlling stake in the CBS television network.)

Philip Morris first bought General Foods in 1985, then Kraft Foods in 1988. With its June purchase of the Swiss chocolate and coffee company, Jacobs Suchards A.G., 38 percent of Philip Morris' profits come from nontobacco products.

Philip Morris is the acknowledged "pricing leader" of the tobacco pack, said Feuerman. He projects Philip Morris' annual earnings growth of 20 to 25 percent for the next decade.

"The only way to stop the Philip Morris machine is to ban smoking, and Washington gave up prohibition in the 1920s," said Prudential-Bache Securities Inc. analyst John McMillin.

But efforts are underway to ban smoking. A shareholder resolution soundly defeated at the Philip Morris annual meeting this year proposed that the company get out of the tobacco business by the year 2000.

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Cigarette sales were banned in 14 states in the U.S. between 1895 and 1927, according to the Tobacco Merchants Association.

These days, anti-smoking efforts range from banning or restricting smoking, to increasing the "sin tax" on tobacco products, to restricting advertising and sales outlets such as vending machines, to persuading institutional investors to divest tobacco stocks, as Southern Illinois University, Harvard University and the City University of New York have done.

Some 425 cities across the country have adopted ordinances restricting smoking in public, said Kevin Goebel, manager of legislative projects for the Berkeley, Calif.-based Americans for Non-Smokers Rights. "Our goal as an institution is that the country should be smoke-free in public." He added: "We don't preach to the smokers. We're trying to protect people from the smoke, not the smokers."

The Administrative Management Society, based in Trevose, Pa., has tracked smoking policies in corporate America for a decade. Survey consultant Joseph McKendrick said the first survey on the topic in 1980 showed 16 percent of companies had a smoking policy. By this year, that had risen to 68 percent.

Last year, McKendrick added, one of four companies banned smoking. This year, that rose to 38 percent. Eighty-one percent of managers surveyed said smoking should be banned in the office, McKendrick said, though many realize it hurts productivity because people then must leave their desks or work areas to smoke.

The tobacco companies raise cigarette prices every year, and Congress is proposing that federal excise taxes, last raised in 1983, be doubled to 32 cents a pack.

Pity the poor smoker. He's an outcast, and he's going to have to pay more.

"The tobacco industry views smokers as a market. The anti-smoking people view smokers as the enemy. Both views exploit smokers," said Bob Rosner, of the Seattle-based Smoking Policy Institute.

The anti-smoking movement contends that 400,000 Americans die every year from smoking-related causes, and it has unsuccessfully attempted to make the cigarette companies legally liable for years. "Everyone believes cigarettes are bad for you, but proving it is very difficult," said Feuerman.

The industry has been assessed damages in only one case, the Cippolone case in New Jersey in 1988, and even that $400,000 verdict against Liggett was recently overturned by the U.S. Court of Appeals in Philadelphia. Even before the verdict was overturned, Feuerman noted, "the number of new cases dropped and the tobacco stocks doubled." Litigation peaked at 170 cases three years ago, and the number of cases outstanding is 60.

In a case that is sure to be appealed to the U.S. Supreme Court, the New Jersey Supreme Court ruled last month in Dewey vs. Brown & Williamson, American Brands and R.J. Reynolds that warnings don't protect cigarette manufacturers from liability suits.

The explosion in U.S. tobacco exports has given the anti-smoking forces a new issue. The merchants of death are now exporters of death, they say.

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And international growth for U.S. tobacco companies is strong, said Feuerman, because "American cigarettes are perceived as higher quality, the U.S. companies have a size advantage in marketing and trade barriers are dropping, especially in the Far East."

Without U.S. exports, per-capita consumption of tobacco still would be rising in some parts of the world, the Tobacco Merchants' Delman said. And people have been smoking for hundreds if not thousands of years. It is a habit unlikely to disappear.

And as long as it remains so profitable, U.S. companies are unlikely to relinquish their leadership position, though the "increasingly hostile environment" for tobacco has become a "way of life" for the industry, said Feuerman.

The new tobacco industry

Cigarette production
In trillions of units
U.S., rest of world, Total, 1981-'88

U.S. exports
In billions of dollars, 1981-'89

Cigarette consumption
In percent for 1985-88

Where it's growing	
China	35.6%
Indonesia	28.3
Dominican Republic	27.0
Thailand	15.9
South Korea	14.5

Where it's declining	
Syria	55.5%
Guatemala	30.1
Venezuela	19.3
Singapore	18.3
El Salvador	14.5

Note: U.S. decline is 8.6%

GRAPHIC: PHOTO (color): Despite growing restrictions on smoking, the operating profit margins on tobacco products still range from 40 to 50 percent, according to analysts. Tribune photo by Steve Johnson.
PHOTO: Some 425 cities across the country have adopted ordinances restricting smoking in public and 68 percent of companies have a smoking policy with 38 percent instituting a ban. Tribune photo by Walter Kale.

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